No. 21810

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of
WESTERN GROWTH CORPORATION,
Bankrupt.

STEPHEN CRANE, III,
Applicant and Appellant,

vs.

CURTIS B. DANNING, etc.,
Respondent and Appellee.

CURTIS B. DANNING, etc.,
Cross-Applicant,

vs.

LOUIS BENVENISTE, *et al.*,
Cross-Respondents and Appellants.

APPELLEE'S BRIEF.

BUCHALTER, NEMER, FIELDS & SAVITCH,
By IRWIN R. BUCHALTER,
727 West Seventh Street,
Los Angeles, Calif. 90017,
Attorneys for Appellee, Curtis B. Danning, Trustee in Bankruptcy.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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APPELLEE'S BRIEF.

I.

JURISDICTION.

The United States District Court, Central District of California, is a Court of bankruptcy, and is vested with original jurisdiction in proceedings under the Bankruptcy Act. (Bankruptcy Act, §1(10), 2; 11 U.S.C. §1, 1(10), 11.) The District Court has jurisdiction to review the orders of the Bankruptcy Court. 28 U.S.C. 1334. This Court has jurisdiction to determine this appeal pursuant to the Bankruptcy Act, §24. (11 U.S.C. §47).

II.
PRELIMINARY STATEMENT.

Prior to August 31, 1959, James A. Bower and Melba Bower (hereinafter referred to as "Bowers") entered into an escrow to purchase 14½ acres of real property in the City of Escondido, County of San Diego, State of California (known in these proceedings and hereinafter referred to as "ESC #3"). The Appellants are 15 of a total of 31 persons who made a total loan of $210,000.00 to Bowers and the Bowers executed a Promissory Note in that amount and further executed a Deed of Trust on the 14½ acre parcel as security for said note.

Thereafter, in August of 1960, 16 of the 31 persons owning $111,000.00 of the full obligation (Appellants, the other 15 persons, participating to the extent of $99,000.00) granted, transferred and assigned to the Bankrupt their respective interests in the loan, represented by the Bowers' note and Deed of Trust, and in lieu thereof, accepted certain unsecured Promissory Notes.

The Referee in Bankruptcy found that the Note and Deed of Trust were null and void but then determined that a fair, just and equitable division of the net proceeds from the sale of ESC #3 would be 33/70ths to the Appellants and 37/70ths to Curtis B. Danning, as Trustee.

The Referee's Order was affirmed by Judge Thurmond Clarke on February 10, 1967.

Appellant then perfected this appeal.

III.

STATEMENT OF THE FACTS.

There are very few facts which were controverted by either side and it is noteworthy that Appellants have failed in their opening Brief except in one or two instances (which will be pointed out to this Court) to attack or disagree with the Findings of Fact made by Hershel E. Champlin, Referee in Bankruptcy, acting in said matter for Ray H. Kinnison, the Referee in Bankruptcy. A summary of the uncontroverted facts and as set forth in the Findings of Fact and Conclusions of Law are that prior to August 31, 1959, the Bowers entered into an escrow to purchase 14½ acres of real property in the City of Escondido ESC #3.

At that time, thereafter, and during these proceedings, Alan Realty Company was a copartnership and a licensed real estate broker. Among the partners of Alan Realty Company were Ted Harris and David Belinkoff, who also became officers and directors of the Bankrupt, Western Growth Corporation (hereinafter referred to as the "Bankrupt") when it was incorporated in or about May, 1960. Bowers employed Alan Realty Company as their broker [Rep. Tr. pp. 190, 193] for the purpose of securing and soliciting 70 loans in the amount of $3,000.00 for a total of $210,000.00 to cover the subdivision of ESC #3 into 70 lots. Alan Realty Company was to collect and make periodic payments to the various lenders on the principal and interest of the loans at such time as such payments would become due. Inasmuch as ESC #3 was not yet subdivided into the 70 lots, the individual lots could not be given as security for each of the $3,000.00 loans, and accordingly, and as an interim meas-

ure only, Alan Realty Company, together with its attorney, Milton White, decided:

(a) To open an escrow [Crane Ex. 6] at the Wilshire Escrow Company, at which each of the lenders would place their money; and

(b) Bowers would make their promissory note in the amount of $210,000.00, payable to "Milton White, Trustee"; and

(c) Bowers would make and execute their Deed of Trust in favor of "Milton White, Trustee," in the amount of $210,000.00 securing a promissory note in the same amount; and

(d) When Alan Realty Company had obtained the 70 loans, or $210,000.00, the escrow would close and the loan proceeds be distributed as follows:

(i) To the North County Escrow Company as a portion of the purchase price owing by Bowers;

(ii) A portion to Alan Realty Company for their services for procuring the loans and for servicing the loans;

(iii) The costs of the escrow; and

(iv) The balance to the Bowers.

(e) When the subdivision was approved and ESC #3 divided into 70 lots, each of the lenders would then receive as security, by way of note and trust deed, one lot for each equivalent $3,000.00 loan (Appellants' Br. p. 7).

Pursuant to the foregoing, Alan Realty Company, on behalf of Bowers, and as the agent of Bowers

[Rep. Tr. p. 193] did solicit and obtain 31 persons who, in varying multiples of $3,000.00, deposited $210,-000.00 in the aforementioned escrow with a short form escrow instruction [Crane Ex. 4] whereby each of the 31 persons authorized the Escrow to accept the instructions of Milton N. White, Trustee. In accordance therewith, the Bowers executed a note [Crane Ex. 1] in the amount of $210,000.00, dated August 31, 1959, payable to the order of Milton White, Trustee, and did further execute a Deed of Trust dated August 31, 1959, which, on its face, conveyed ESC #3 as security for the said Promissory Note and named Milton White, Trustee, as beneficiary [Crane Ex. 2]. Neither the Note nor the Deed of Trust sets forth on its face on whose behalf, if anyone, the said Milton White was acting as Trustee. On September 8, 1959, the Deed of Trust was recorded. At the same time the Escrow disbursed $31,500.00 to Alan Realty Company for its services, as hereinabove set forth; $67,500.00 paid to the North County Escrow Company as the balance of the purchase price due and owing by Bowers; $110,-182.20 was paid to Bowers and balance was used for costs of escrow and other costs in connection with the loan [Wilshire Escrow Company "Escrow Settlement" —Clk. Tr. p. 99].

The Escrow Company at that time delivered the $210,000.00 Promissory Note to Alan Realty Company and not to Milton White. Upon recording, the County Recorder of San Diego County mailed the Deed of Trust, pursuant to written instructions on the document itself, to Alan Realty Company and not to Milton White. Alan Realty Company received and retained both documents [Exs. 1 and 2] in its possession, and

it is further undisputed that Milton White never received possession of either the Promissory Note or the Deed of Trust [Rep. Tr. p. 52]. None of the 31 persons who placed money in said escrow ever obtained possession of the Promissory Note or the Deed of Trust.

It is further admitted that ESC #3 was never subdivided and it is the uncontroverted testimony that there was never in existence an Agreement or Declaration of Trust whereby Milton White was designated as Trustee [Rep. Tr. p. 61] or whereby any person or persons were designated as the beneficiary or beneficiaries of any trust concerning ESC #3 in which Milton White was named as the Trustee; that he signed the Escrow Instructions upon the instructions of Alan Realty Company [Rep. Tr. pp. 65, 66 and 68]; nor did Mr. White know who the beneficiaries of such purported Trust might have been nor their interest therein [Rep. Tr. pp. 52, 217]. Mr. White never saw Crane Exhibit 4, the instructions of the lender(s) to the Wilshire Escrow Company [Rep. Tr. p. 83] nor did he receive instructions from anyone under which he was to operate as Trustee [Rep. Tr. p. 61].

Thereafter, on June 11, 1960, Bowers sold ESC #3 to the Bankrupt [Rep. Tr. p. 80] subject to any and all encumbrances thereon. Appellants suggest that there is a factual dispute over whether or not the Bankrupt purchased ESC #3 subject to the Deed of Trust or expressly assumed the same. This suggestion is completely without merit. First, it is the specific finding of the Referee [Findings of Fact and Conclusions of Law Par. 19, p. 10; Clk. Tr. p. 167] that the Bankrupt obtained title to the same *subject* to any

and all encumbrances thereon. Secondly, the matter was thoroughly covered by Paragraph III of the Pretrial Conference Order, and Appellee respectfully calls to this Court's attention that this was not a joint Pretrial Conference Order but was prepared by Appellants and stipulated to by both parties. Counsel cannot at this late stage repudiate its stipulation or the Court's Pretrial Order. (See Stipulations 46 Cal. Jur. 2d 9; *Allen v. Gardner,* 142 Cal. App. 2d 467, 298 P. 2d 585.) This portion of the Pretrial Conference Order set forth on page 95-e of the Clerk's Transcript reads as follows:

"III

"The following facts are admitted and require no proof:

. . . 8. That on or about June 11, 1960, by written agreement, the Bowers sold certain of their assets, including the real property, to certain persons or their nominee and that on or about July 1, 1960 by written escrow instructions, the Bankrupt was named as the nominee under said Purchase Agreement and thereafter the Bankrupt took title to the real property *subject to* all encumbrances of record in respect thereto."

(Italics added for emphasis)

Accordingly, it is totally immaterial as to the meaning of Paragraph 14 of the Second Crane Exhibit No. 3 with reference to the contract of June 11, 1960. Appellee does not agree with the interpretation thereof placed on this exhibit as the same was a transaction in which the Bankrupt was far removed.

Appellee would like to comment at this time (and will show later in this brief similar instances) mis-

statements made by Appellants in their brief of various of the authorities cited by them. On page 10 of their brief they cite the companion cases decided by this reviewing Court of *Bass v. Quittner, et al.,* 381 F. 2d 54 (9 Cir. 1967) and specifically cite such cases as authority for their statement

> "that where no question of credibility involved both it and District Judge had the responsibility to reexamine Finding and make independent judgment."

The actual and exact quotation is as follows:

> "The Referee's 'findings' that the services were of no benefit to the estate were essentially conclusions which the district judge was competent to reexamine. (citing cases) Our court, too, is required to reexamine such *conclusions,* whether made by the Referee or the district judge." (emphasis added)

The difference in the actual quotation and Appellants' construction thereof is that this reviewing court is required to reexamine conclusions and not as inferred by Appellants the facts. Were it not for the stipulation of the parties in the pretrial conference order the finding of fact that the Bankrupt took title to the real property *subject to* all encumbrances of record might at best be a conclusion of law, but as a stipulation in the pretrial conference order it is a finding of fact and not a conclusion of law which this court should reexamine. Even if this court should reexamine this as a conclusion, this court will come to the same conclusion as the Referee and the District Court.

Appellee agrees with Appellants that the only other relevant fact was that a very short time later, August, 1960 and before any default, 16 of the 31 persons who placed the $210,000.00 into the loan escrow and who participated in the full amount of the loan in the proportion of 37/70ths thereof and in the sum of $111,000.00 (Appellants participating to the extent of 33/70ths thereof, $99,000.00) granted and transferred to the Bankrupt their respective interests in the loan represented by the Bower Promissory Note and Deed of Trust and in lieu thereof, accepted certain unsecured promissory notes. Such assignment was made substantially in the form as set forth in Danning's Exhibit E [Clk. Tr. p. 102] and as found by the Referee, said assignment granted, assigned and transferred to the Bankrupt all of the person's beneficial interest under the said Deed of Trust and said Promissory Note, together with the money due and to become due thereunder, together with interest and all rights accrued or to accrue under said Deed of Trust [Findings of Fact and Conclusions of Law, Par. 20, p. 10; Clk. Tr. p. 167]. The Referee further found in the same Finding, Par. 20, and Appellants do not challenge such Finding, that neither the Bankrupt nor any of the said 16 persons intended by the execution of said Assignment that their proportionate share of the loan be satisfied, paid or discharged, but on the contrary, it was their intention that said loans continue in existence and become the property of the Bankrupt.

As stated in Appellants' Opening Brief at page 7, payments of said loan were made by Alan Realty Company, on behalf of the Bowers, during the period of time that the property was owned by the Bowers to

the individual lenders. The only other conflict in the construction concerning the evidence is whether or not Alan Realty Company was the agent of the owners, either Bowers or the Bankrupt, or the agent of the lenders. During this period of time the payments on the loan were made to the lenders. The Court specifically found as Appellee contended with reference to this conflict that Alan Realty Company was acting as the agent for and on behalf of Bowers and the Bankrupt during their respective ownership of ESC #3 [Findings of Fact and Conclusions of Law, Par. 25, p. 13; Clk. Tr. p. 170]. Thereafter, Alan Realty Company continued making the payments for the Bankrupt during the period that the Bankrupt was the owner. All fees were paid either by Bowers or by the Bankrupt. None of the fees, or any consideration, was paid by the Appellants.

Though the Court subsequently concluded that the promissory note and Deed of Trust made by Bowers in favor of Milton N. White, Trustee, was null and void and of no further force and effect [Conclusions of Law, Par. 4, p. 15], the Court being a Court of Equity, nevertheless found that it would be fair, just and equitable that the net proceeds of the sale of ESC #3 be divided 33/70ths to the Cross-Respondents and 37/70ths to Danning, as Trustee of the Bankrupt; the foregoing being based upon the pro rata percentages of each Group of the total $210,000.00 loan.

The Trustee also filed a Petition for Review from that portion of the Order of the Referee dividing the

proceeds as hereinabove set forth on the basis that the Referee having found the Note and Deed of Trust to be null and void, that the Appellants were not entitled to any such division and were mere unsecured creditors. The Trustee, however, thereafter conceded to the District Court that should it agree that the Bankruptcy Court being a Court of Equity, could find and order that an equitable lien existed in favor of Appellants as to 33/70ths of the net proceeds to be derived from the sale, that the Trustee would accept such decision of the Reviewing Court, and accordingly, no further appeal has been filed by the Trustee from the decision of the District Court.

IV.

ISSUES PRESENTED.

There are only two issues involved in this matter and they are as follows:

(1) Whether or not the Referee committed error in holding that a fair, just and equitable division of the net proceeds of 33/70ths to the Cross-Respondents and 37/70ths to Curtis B. Danning, as Trustee, is correct.

(2) Having found that such Promissory Note and Deed of Trust are null and void, can the Referee nevertheless sitting as a Court of Equity hold that Appellants are entitled to an equitable lien upon an undivided 1/70th interest in ESC #3 for each $3,000.00 and the corresponding interest in or to the net proceeds derived from the sale of ESC #3?

V.

ARGUMENT.

1. The Promissory Note and Deed of Trust Given as Security Therefor Is Null and Void and of No Force and Effect.

(A) Neither the Promissory Note nor the Deed of Trust Were Delivered by the Makers to the Beneficiary.

The uncontroverted testimony as heretofore set forth clearly indicates that "Milton White, Trustee", the purported payee and beneficiary of the Promissory Note and Trust Deed, never had possession of either of the documents. David Belinkoff testified that the documents were in the possession of Alan Realty Company, a copartnership, of which Belinkoff was a partner until after bankruptcy. This possession by Alan Realty Company, therefore, is of importance on this issue. An examination of Trustee Danning's Exhibits A, B and C, The Escrow Settlement Work Sheet, the Escrow Statement, and the Escrow Instructions [Clk. Tr. pp. 96, etc.] clearly indicate that Bowers, the makers of the Note and Deed of Trust, paid a real estate broker's commission to Alan Realty Company, and as set forth hereinbefore under Trustee's Statement of Facts, Alan Realty Company obviously was the agent of the Bowers. There is no evidence whatsoever that Alan Realty Company was the agent or representative of Appellants under the so-called Trust in which Milton White was the alleged Trustee.

Delivery is a requisite to the validity and operation of a Deed of Trust (C.C.P. 1933; *Miller v. Jansen,* 21 Cal. 2d 473; 132 P. 2d 801). The mere signing of a deed by the grantor and acknowledgment by the grantor are not sufficient to divert the grantor of title.

Delivery is essential. (*Miller v. Jansen, supra,* and other cases cited therein). Possession by the grantee gives rise to an inference that the instrument was duly recorded. But possession by the *grantor* has been informally held to make out a case of nondelivery, unless actual delivery be shown, and that the grantor's possession was merely for safekeeping or similar purpose (*Miller v. Jansen, supra*).

The burden of proof is on the Appellants in an action to foreclose to establish the existence of the Deed of Trust in Appellants' favor (*Siter v. Jewett,* 33 Cal. 92). Appellants have completely failed to meet this obligation for they have not established that the Deed of Trust and Promissory Note were delivered.

A very similar situation took place in *Nobel v. Learned* (153 Cal. 245; 94 Pac. 1047). One Lee executed an assignment of stock certificates to Learned, delivering the certificates to Noble. The Court held that the mere assignment without delivery to Learned did not vest title or any rights in Learned. In the instant case the Bowers signed a conveyance (Deed of Trust) and Promissory Note in favor of Milton White, but delivered it to Alan Realty. There is no showing that Alan Realty was White's agent or that Alan Realty's possession was White's possession. Following the *Noble* case *supra,* White got nothing.

Appellee does not quarrel with the authorities cited by Appellants such as *Butler v. Butler,* 188 Cal. App. 2d 228; 10 Cal. Rptr. 382, nor Section 3 of the Article on Brokers in 9 Cal. Jur. 2d excepting that the Appellee would like to point out it is his theory that the proof actually shows failure of delivery. Appellants concede that the presumption of delivery is re-

buttable and it is the position of the Appellee that not only has it been rebutted but that the proof clearly indicates that no delivery of any kind was made.

The question as to whether or not a broker may, under certain circumstances, act as the agent of both parties is not herein involved; nor is the fact that he received his fee from a particular person one of the issues. The evidence is clear that Bowers employed Alan Realty Company to obtain the funds for the loan, paid Alan Realty Company a commission for obtaining the loan, Alan Realty Company collected the funds and disbursed the loan payments to the Appellants and the other lenders. It is the uncontroverted evidence that two of the principals of Alan Realty Company were officers, stockholders and directors of the Bankrupt, and even after the conveyance to the Bankrupt, Western Growth Corporation, Alan Realty Company made payments to the lenders even before Western Growth, the Bankrupt, made the payments to Alan Realty Company, or, in effect, Alan Realty Company actually advanced the money for the owner, Western Growth, to the lenders before receiving the money [Rep. Tr. p. 106, lines 8-18]. It was the Bankrupt who obtained assignments of 16 of the lenders of their various interests. It is, therefore, without a question that Alan Realty Company, during the entire time that it held the Promissory Note and Deed of Trust, was the agent first, of Bowers, and second, of the Bankrupt, and was not the agent of the Appellants. Appellants concede in their Opening Brief commencing with Paragraph b on page 17 and thereafter on page 18, that it was Bowers who directed that the Deed of Trust be delivered to Alan Realty Company, and the Trustee

finds no fault with the cases cited by Appellants concerning agreement made by parties as to delivery of a deed to third parties; but nowhere do Appellants in their Brief point out to this Court testimony or agreement which the 31 lenders made whereby they directed that the Note and Deed of Trust be delivered at their instance and request to Alan Realty Company. The fact that the Deed of Trust was delivered to the Escrow Company by the makers does not constitute such an agreement because the Escrow Company merely retained the same as agent for all of the parties and then caused the same to be mailed by the County Recorder to Alan Realty Company.

(B) A Valid Trust in Which Appellants Were the Beneficiaries Never Existed.

Assuming *arguendo* that Milton White was the Trustee for the Appellants, still no trust was ever created.

The theory of Appellants is that Milton White held the payee's interest in the Promissory Note and the beneficiary's interest in the Deed of Trust as Trustee of a trust in which the Appellants were beneficiaries.

We are here talking about the alleged trust by which Milton White was the Trustee and the Appellants the beneficiaries, as distinguished from the alleged trust created under the Deed of Trust in which Milton White was the beneficiary and Wilshire Escrow Company, the Trustee.

The burden of proof of establishing a trust is on the party attempting to establish the trust (*Cohn v. Cohn,* 130 Cal. App. 349; 20 P. 2d 61). This party is Appellants.

What is the evidence in this regard? The trust *res* (the Note and Deed of Trust) were never delivered to Milton White and it never came into his possession (see above for discussion). The trust *res* was in the possession of Alan Realty, who were the brokers and agents of the trustor (Bowers). There is no trust agreement. Milton White, the alleged Trustee, never knew who the alleged beneficiaries were or their interest. There was no designation of beneficiaries. He received no instructions, never saw Exhibit 4, the instructions of the lenders, and he signed the Escrow Instructions at the request of Alan Realty Company.

To constitute a valid express trust, it is essential that there be (1) a trustee, (2) an estate conveyed to him, (3) a beneficiary, (4) a legal purpose, and (5) a legal term. (*Johnston Estate,* 47 Cal. 2d 265, 303 P. 2d 1; *Walkerly Estate,* 108 Cal. 627, 41 Pac. 772). Equity will in some cases make good the absence of a trustee, but if one of the other essentials are lacking the trust itself must fail (*Walkerly Estate,* 108 Cal. 627, 41 Pac. 772).

It is essential to the creation of an express trust that some estate or interest be actually conveyed or transferred to the Trustee (*Nichols v. Emery,* 109 Cal. 323, 41 Pac. 1089; *O'Neil v. Ross,* 98 Cal. App. 306, 277 Pac. 123). There being no delivery to White of the *res,* the conveyance or transfer was incomplete, and White got nothing (*Noble v. Leonard,* 153 Cal. 245; 94 Pac. 1047).

Further, there does not appear to be any evidence of who the beneficiaries of the trust were. The purported Trustee, White, testified he did not know who they were. Not one of the alleged beneficiaries came forward to testify to the fact he was a beneficiary.

Appellants, in their Opening Brief, beginning on page 18, lay great stress on the argument that Milton White acted as a dry or passive Trustee and as such took title to the Note and Trust Deed in their behalf and in behalf of all 31 lenders. Appellee does not agree with the conclusions of Appellants that Referee Champlin and/or Judge Thurmond Clarke failed to appreciate the nature of the trust because the Referee looked for a trust *res* and did not recognize that there had been created a dry or passive trust. Appellee does not find fault with the argument that under the laws of the State of California a valid, dry or passive trust may be created. Appellee, however, takes the position that under Civil Code Section 2220 of the State of California and *Engineering, etc. Corp. v. Longridge Investment Co.,* 153 Cal. App. 2d 404; 314 P. 2d 563, that no passive or dry trust was created because it was not created under the terms of any contract. In a dry trust the beneficiary is entitled to actual possession and enjoyment of the property and to dispose of it and call on the Trustee to execute such conveyance as he directs. In short, the beneficiary has absolute control over the beneficial interest. Together with the right to call for the legal title (*Ringrose v. Gleadall,* 17 Cal. App. 664; 121 Pac. 407). Let us assume for

the purpose of this discussion that a dry or passive trust was created. The Trustee, as the evidence clearly indicates, does not know who are the beneficiaries, or what is their interest. Thirty-one persons, the beneficiaries, have control over the beneficial interest and the right to call for the legal title. How does the purported Trustee, Mr. White, take instruction to call for such legal title, and assuming that he knows or is advised as to who they might be, does he take the instruction of one, or more, the majority in number or interest, or does it require all of the beneficiaries to call for the legal title. It is the position of the Appellee that Appellants must meet the burden to prove that a trust, whether dry or passive, was created and the legal purpose thereof. There was no conveyance of the trust *res,* no beneficiaries, and accordingly, it is the position of the Appellee that the trust must fail.

Appellee would, however, like to point out to this Court that it is Appellee's position that this was not a dry or passive trust because of the fact that under the evidence Milton White had certain duties. Appellants' Exhibit 4 (Dr. Zane's Escrow Instructions) indicates the money deposited by the 31 lenders was to be used on White's instructions. This would seem to indicate that if a trust was created, White had duties and was more than just a passive Trustee. The question is not whether or not the trust was passive or active, but the question is, was there a legal trust or not?

2. **Are Appellants Entitled to an Aggregate Interest of 33/70 in ESC #3 and in the Net Proceeds From Any Sale Thereof, and Is the Appellee, Trustee in Bankruptcy, Entitled to the Remaining 37/70 Interest Therein?**

Although it was the position of the Appellee before the District Court that the Referee having held the Promissory Note and Deed of Trust void, that Appellants were entitled to nothing above that allowed to general unsecured creditors. In the Memorandum of Points and Authorities filed by the Appellee with the Honorable District Court, Appellee concluded that if the District Court agreed with the ruling of the Referee in Bankruptcy, that Appellants were entitled to some recognition; that it would then be the position of the Appellee that the decision of Referee Champlin was proper and each of the Appellants is only entitled to that portion of the proceeds of any sale of the real property that his original loan bore to the entire loan.

The Referee found that it was fair, just and equitable that the net proceeds of the sale of ESC #3 be divided 33/70 to the Appellants and 37/70 to the Appellee, Trustee, and concluded that an equitable lien to the Appellants existed as to the proceeds of sale in such respective amounts [Findings of Fact, Par. 32, Conclusions of Law, Par. 7]. The parties stipulated that the original total loan amounted to $210,000.00; was comprised of 70 units of $3,000.00 each; that the Appellants' group represents 33 units totalling $99,000.00, and that the balance of the lenders totalling $111,000.00 assigned their respective interests in the Note and Deed of Trust to the Bankrupt herein. It was further stipulated that the Bankrupt acquired

title to the real property *subject to* all encumbrances of record [Pretrial Conference Order p. 4, lines 2-17; Clk. Tr. p. 95e].

Inasmuch as counsel for Appellants cited many cases involving an assumption of an obligation by a grantee as distinguished from the grantee acquiring real property subject to an encumbrance, the distinction becomes one of some importance.

Where property is mortgaged, the property itself is primarily liable for the debt (*Wenzel v. Schultz,* 100 Cal. 250, 34 Pac. 696). A grantee of the property is not personally liable unless he specifically assumes liability (*Bogart v. Porter Co.,* 193 Cal. 197, 223 Pac. 959; *Andrews v. Robertson,* 177 Cal. 434, 170 Pac. 1129). A conveyance merely subject to a mortgage imposes no personal liability for the mortgage debt on the grantee (*Andrews v. Robertson,* 177 Cal. 434, 170 Pac. 1129). Similarly, a purchaser of property subject to a trust deed is not ordinarily liable personally for the debt secured (*Wolfert v. Guadagno,* 130 Cal. App. 661, 20 P. 2d 360). To take advantage of an agreement to assume a mortgage, it is the mortgagee's duty to show affirmatively that the grantee made the agreement with the mortgagor (*Thomson v. Bettens,* 94 Cal. 82, 29 Pac. 336). There is no evidence of any assumption, only a stipulation and pretrial order that Western Growth acquired the property subject to the encumbrances, if any.

The beneficiaries' security interest in the real property was an undivided 1/70 interest for each $3,000.00 loaned.

It has been stipulated by the parties that originally there were 31 persons who loaned 70 units of $3,-

000.00 each for a total of $210,000.00. About August, 1960 before a default in the repayment schedule, 16 of the 31 persons, in consideration of the assignment of such obligation and security interest to Western Growth, received from Western Growth a new unsecured obligation. As a result of these transactions either: (1) the 70 units of $3,000.00 each are still outstanding and Western Growth is the owner of 37/70 undivided interests in the security and Appellants own the remaining 33/70 undivided interests therein; or (2) there in only 33/70 undivided interests in the security still outstanding and Appellants owned these.

Appellants' Exhibit 8 [the letter of David Belinkoff dated February 5, 1962; Clk. Tr. p. 128] was introduced and received by the court for the purpose of showing the security each of the alleged beneficiaries had in the real property, if they had any at all.

Exhibit 8 relied heavily upon by Appellants, designates that each of the alleged beneficiaries had a 1/70 undivided interest in the property for each $3,000.00 loaned. This is Appellants' own exhibit; in the absence of other evidence, they are bound by it. Since Appellants represent 33 units, they would be entitled to a maximum of 33/70 undivided interest in the real property as security, and on sale of the property, they should get a maximum of 33/70 of the net proceeds of sale.

Further, if Appellants' contentions are correct, originally there were 70 units of $3,000.00 each loaned to Bowers and a Deed of Trust given to secure this loan. If prior to the time that some of the lenders were divested of their interests there had been a foreclosure sale, each lender would have received 1/70 of the net sale price for each $3,000.00 loaned.

Is there any reason to give the 15 remaining lenders (Appellants) more than 1/70 for each $3,000.00 loaned? To do so would be to give them a windfall at the expense of the unsecured creditors of this bankruptcy estate. The Court would have to say that because the other 16 lenders were divested of their interests by transferring their interests to the Bankrupt, Appellants increased their bargained-for security interest from 1/70 for each $3,000.00 loaned to 1/33 for each $3,000.00 loaned, at the expense of unsecured creditors. The result would distort the original agreement and should not be allowed to come to pass.

There is uncontradicted evidence [Rep. Tr. pp. 90, 91] by both Ann Fostoff (a former employee of Western Growth and Alan Realty) and [Rep. Tr. pp. 107, 108] Belinkoff (a partner of Alan Realty and officer, director and stockholder of Western Growth) that when each of the 16 lenders received consideration for their share of the units they (the 16 Lenders) executed and delivered an Assignment of Deed of Trust and Promissory Note to Western Growth on a form similar to Danning's Exhibit E [Clk. Tr. p. 102]. This then shows an intention by these Lenders and by Western Growth that there be an assignment of these Lenders' rights to Western Growth; that there was not nor was it intended to be a discharge of the obligation and security. The question, then, is whether by operation of law the debt and security were discharged, so that Western Growth did not acquire any interest in the loan and security. It is Appellee, Danning's position that the debt did not become discharged and that the bankrupt estate owns and should participate in the proceeds of any sale of the security.

On the other hand, Appellants contend that the Bankrupt acquired the interests of the 16 original Lenders, a merger of title took place, and accordingly the security interest of the 16 Lenders merged into Western Growth's fee title. Appellants' attempt to use the merger doctrine against the Bankrupt cannot prevail.

In *Jameson v. Hayward,* 106 Cal. 682, 688 (39 Pac. 1078) the Court stated the rules as to when equity would act, as follows:

> ". . .[E]quity will prevent or permit a merger, as will best subserve the purpose of justice, and the actual and just intent of the parties. In other words, equity is not guided by rules of law as to merger. In the absence of an expression of intention, if the interests of the person in whom the several estates have united, as shown from all the circumstances, would be best subserved by keeping them separate, the intent so to do would ordinarily be implied."

The Court need not determine what the results should be if the Bowers (the borrowers and principal and primary debtors) had paid the debt or had taken an assignment of the debt. The uncontroverted facts are that the Bowers did not pay the debt or take an assignment of the debt. Western Growth did.

As set forth above, it was stipulated in the Pretrial Conference Order that Western Growth acquired the property *subject* to the encumbrances [Par. 8, p. 4, lines 12 *et seq.* of the Pretrial Conference Order]. There is no evidence that in addition they assumed the encumbrance. Therefore, Western Growth is not and was not the primary or principal debtor. This distinc-

tion is of importance because in the citations of Appellants the persons who paid or took an assignment of the debt was either the (1) borrower or (2) had assumed the debt which led to an extinguishment of the debt.

Appellants cite *Dowds v. Spring,* 174 Cal. 412; 163 Pac. 351, in support of their contention that Western Growth's taking of the assignment of the debt and security extinguished the debt and security. In that case, at the time of payment by the *assuming* grantee, William A. Kjellman, and his taking of an assignment of the debt, the grantee had already divested himself of the fee by a conveyance to another, and therefore, he did not own an interest in the real property. Since he did not own an interest in the property, the rule of *Jameson v. Hayward,* 106 Cal. 682; 39 Pac. 1078, did not apply for Kjellman would not benefit by preventing an extinguishment. In the instant case at the time of the assignment Western Growth owned the fee and had not assumed; therefore, the case is clearly distinguishable on two grounds. Kjellman was the primary obligor, Western Growth was not. Kjellman assumed the debt, Western Growth did not.

In *Liddle v. Lechman,* 114 Colo. 189, 163 P. 2d 802, a *Colorado* case, the Court found that the *assuming* grantee *intended* to extinguish the debt and security in that in obtaining a subsequent loan on the property, the subsequent lender was advised the money would be used to pay off the prior loan and the subsequent lender would get a security interest free and clear of all prior encumbrances. Therefore, in the *Liddle* case there was an actual intent to extinguish. In the instant case the uncontroverted facts are that Western Growth did not

intend to extinguish the loan and security, but on the contrary received an assignment of each of lender's interest. But even if the assignment does not indicate such intent, the rule of *Jameson v. Hayward,* 106 Cal. 682, 39 Pac. 1078, would control. In the absence of evidence of intent, it being clear that Western Growth's interests would be best served by allowing the obligation and security to remain alive, the Court should not declare a merger. Also, the *Liddle* case indicates there was evidence of an assumption.

In *Malinoski v. Mekody,* 48 N.Y.S. 2d 940, a *trial* court case and one relied upon by Appellants, Malinoski (the owner) gave a bond and security interest to one Bucaniec covering two parcels of land. Later Bucaniec assigned the bond to Bronner and Bronner immediately assigned 12/40 of the bond back to Bucaniec and 28/40 to Kuehnle. Years later Malinoski (the owner) deeded the land to Mekody, who assumed the bond and mortgage. Thereafter, Bucaniec signed and recorded a release of his security interest in part of the real property. He also *assigned* his interest in the bond and remaining security to Malinoski, the former owner.

In a foreclosure suit by Kuehnle against Mekody (as assuming fee owner) and Malinoski as the *original* mortgagor, the Court held that as Malinoski was the original mortgagor, any interest he still claimed in the property was subject to his original mortgage. This is a great distinction as in the instant case, Western Growth is not the original mortgagor and there is no contract of assumption for the benefit of the lenders; therefore, *Malinoski* does not apply. Further, in *Malinoski* there does not appear to be any intent that each por-

tion of the loan be secured by an undivided interest. The Malinoski loan was from one person and did not contain release clauses. In the Bowers Note and Deed of Trust there is an intent manifested that for each $3,000.00 paid, 1/70 of the security be released. This case differs from Malinoski considerably and it should not control.

Whatever the law of Colorado and New York may be, the law of California clearly gives Western Growth an interest in the loan. In *Matzen v. Schaeffer,* 65 Cal. 81, 3 Pac. 92, the appellant, Matzen, purchased land from an owner thereof subject to a mortgage. Prior to the sale, but after the mortgage was placed on the property, Schaeffer obtained a judgment lien on the property. At the time of the purchase Matzen paid off the mortgage and the mortgagee satisfied it. Schaeffer executed on the property and obtained a Sheriff's deed. In this suit to quiet title the Court said, at Page 82:

> "This presents a case in which the interests of the appellant required that the lien of the mortgage which she paid off should be kept alive. Her interests can only be fully protected by regarding the transaction in which she paid off the mortgage as an assigment of it to her, and the lien as being kept alive for her security and benefit. 'In general, *when any person having a subsequent interest in the premises, and who is therefore entitled to redeem, for the purpose of protecting such interest, and who is not the principal debtor primarily and absolutely liable for the mortgage debt, pays off the mortgage, he hereby becomes an equitable assignee thereof, and may keep alive and enforce*

> *the lien so far as may be necessary in equity for his own benefit; he is subrogated to the rights of the mortgagee to the extent necessary for his own equitable protection.'* (Italics added for emphasis) (3 Pomeroy's Eq. Juris. §1212.) And this equitable result follows, 'even though a receipt was given speaking of the mortgage debt as being fully paid, and sometimes even though the mortgage itself was actually discharged and satisfied of record.' (3 Pomeroy's Eq. Juris. §1212.)"

The Court then presumed an assignment even though the debt was discharged, and preserved the mortgage and obligation for Matzen, giving her a superior right to Schaeffer.

In *Barnes v. Cady,* 232 Fed. 318 (6th Cir. 1916), the Circuit Court of Appeals, Sixth Circuit, followed the *Matzen* case *supra,* and held that a grantee who paid off the first mortgage on the property was subrogated to the rights of the first mortgage and was to be considered an equitable assignee of the holder of the first mortgage as against a subsequent encumbrancer, notwithstanding a satisfaction of the mortgage and debt secured thereby.

Both the *Matzen* and *Barnes* cases, the letter in Federal Court, support Appellee Danning's position and should be followed: that is, there was no merger of title when Western Growth took an assignment of 37/70 of the loan.

Appellee takes great exception to the statement made in Appellants' Opening Brief on Page 26 concerning the citation of *Wilson v. McLaughlin,* 20 Cal. App. 2d 608; 67 P. 2d 710. Counsel omitted a paragraph

from the case which belongs between the two paragraphs cited on Page 27. Appellee respectfully calls this Court's attention to the paragraph which belongs in between these two paragraphs, which states the position of the Appellee and reads as follows:

> "The principle of these equitable rules has no application to the facts in evidence. The deed to Mrs. Nelson recited as follows: 'It is expressly agreed that as a consideration for the within conveyance, the Grantee herein *expressly assumes and agrees to pay* and discharge a mortgage in the sum of $30,000.00, now against the property, together with accrued interest thereon, as well as all taxes and special assessments levied or to be levied against the above described property.' *Thus she became the principal debtor* and her grantor a surety. (*Williams v. Naftzger,* 103 Cal. 438 [38 Pac. 411]; *Tulare County Bank v. Madden,* 109 Cal. 312 [49 Pac. 1092]; *Small v. C. R. Rogers, Productions,* 11 Cal. App. (2d) 191 [53 Pac. (2d) 774], and cases there cited.)" (Emphasis added).

The foregoing paragraph in *Wilson v. McLaughlin* again points out the substantial difference between "subect to" and "assumption" of the debt. The ruling made by the Court in *Wilson v. McLaughlin* is because of the fact that Mrs. Nelson, the grantee therein *"expressly assumes and agrees to pay and discharge a mortgage",* and it is this position that the Appellants fail to recognize. The Bankrupt under the facts, the testimony, the stipulation and pretrial order did not in any manner assume the obligation of the Note and Deed of Trust.

If as Appellants contend, but have not proved, Western Growth paid off the obligations of 37/70 of the original lenders, rather than taking an assignment of their obligation, then the Court should declare the transaction was as if a reconveyance of 37/70 undivided interest in the real property took place so that 37/70 undivided interest is free and clear.

The Deed of Trust contained the following release clause:

> "It is understood and agreed by and between the Trustor and Beneficiary, as follows: The land described in this Deed of Trust is to be subdivided into 70 lots. So long as the Trustor shall not be in default in any of the covenants contained herein or in the payments due on the Promissory Note secured hereby, a partial reconveyance may be had and will be given from the lien or charge hereof of any one or more of the subdivision lots hereinbefore described, upon payment of an amount to apply on the principal of said Note based on the rate of $3,000.00 per lot for each lot so reconveyed, plus accrued interest and any prepayment penalty as called for in said Note."

Admittedly, the provision states that the property is to be subdivided into 70 lots, but there is no promise on anyone's part to do so. The condition of the release clause is:

> "So long as the trustor shall not be in default in any of the covenants contained herein or in the payments due on the Promissory Note secured hereby . . ."

It has been stipulated that there was no such default at the time of the payment by or taking of an assignment by Western Growth of 37/70 of the obligation and security. Therefore, the condition was met. There was no condition regarding subdividing the property. Since 37 units of $3,000.00 were at least paid off, Western Growth should get the benefit of the bargain and get a release of 37/70 of the property. This is fair, just and equitable and as a result, Appellants still have a security interest in 33/70 of the property, which is all they bargained for. The fact that their interest is undivided, rather than divided, does not prejudice them as the Trustee, Danning, intends to sell once title to the property is determined. It must be apparent to this Honorable Court that such selling price will not equal the loan amount of $210,000.00 plus delinquent taxes, etc., or this entire proceeding would be moot.

On page 32, Paragraph 3 of their Opening Brief, Appellants take the position that the Bankrupt assumed the Note and Deed of Trust, but even assuming *arguendo* that the purchase was made by the Bankrupt subject to, it is their contention that the law is well settled that where the "subject-to grantee" takes an assignment of the mortgage, the debt secured by the mortgage is held to be extinguished.

The question of whether or not the Bankrupt assumed the Note and Deed of Trust or took the same subject to the Note and Deed of Trust has been discussed in full and no further comment will be made hereat concerning this question.

Again, Appellants have failed to set forth in their Opening Brief the entire citation cited on Page 33 as

95 A.L.R. 89, 107. So that this Court will have the benefit of the entire citation, the omitted portion is set forth as follows, and there is italicized that portion which Appellants failed to include in their Memorandum:

> "As a general rule, where a purchaser of land subject to a mortgage takes an assignment of the mortgage, the debt secured by the mortgage is extinguished, and *personal liability therefor cannot be enforced.*"

All of the cases cited under this annotation are cases which the mortgagee attempted to obtain a personal judgment against the maker or accommodation maker on the theory that the land was the primary fund for the payment of the debt and the Courts refused to render a personal judgment or deficiency judgment in each of these cases. And again, in the citation of Appellants in 37 Am. Jur. Mortgages, Section 1324, the entire Section refers to *the enforcement of personal liability.* Further, the next sentence following the citation of Appellants and omitted, reads as follows:

> "Ordinarily, however, the prevailing rule is that the question of whether there is an extinguishment of the *personal* liability for the mortgaged debt on the acquisition of the mortgage and the mortgage debt by grantee of the mortgaged premises is one of intention."

From the foregoing, it is readily apparent that no personal liability for the mortgaged debt could be recovered against the Bankrupt because it was not intended nor is there any evidence that the mortgagor would have any personal liability and if the mortgagor

(Bowers) could have no personal liability it is apparent that the Bankrupt had none either.

The equitable prevention of merger doctrine is applicable in this case. There is no doubt that a Court of Equity can prevent a merger and this doctrine is applicable here, and in response to Appellants' Point 4 in their Opening Brief, Page 35, it is sufficient merely to point out, through their own Brief, that this doctrine is available to prevent other persons to obtain a windfall from the owner's payment. (*Osborne on Mortgages,* p. 773).

The facts are uncontroverted. Appellants each received, at best, a 1/70 undivided interest in the real property as security for each multiple of $3,000.00 loan [Ex. 8]. They were of the opinion that each of them was secured and that the value of the land was equal to or in excess of such loan. They now request this Court to give them all of the land, eliminating 37/70, or in other words, for each multiple of $3,000.00 a 1/33 interest instead of what they bargained for, a 1/70 interest. This is reaping a windfall for them at the expense of the other 37/70. This is more than they bargained for and is at the expense of the unsecured creditors. The Pretrial Order provides approximately that $500,000.00 of secured notes were exchanged for non-secured notes of the Bankrupt. Are the holders of these notes not entitled to some consideration? In Appellants' Conclusion, they refer to a "swap" and refer that the unsecured creditors of the estate were aided by such "swap". On Page 4, Lines 18-22 of the Pretrial Conference Order [Clk. Tr. p. 95e] the parties admit that the "swap" was for unsecured notes of the Bankrupt, or a substitution of one

obligation for another. There is no evidence that these new obligations were paid, and as a matter of fact, the same are unpaid. Are not these creditors who "swapped" in a worse position for the reason that they do not now have any secured claim and have to participate with all of the other unsecured creditors whose claims are in the millions?

The cases cited by Appellants under this point have been fully discussed in this Reply Brief and bear no further discussion.

Conclusion.

The Referee in Bankruptcy was more than fair with the Appellants. He has found that the Note and Deed of Trust were null and void and that no trust is created. Although it is the opinion of the Appellee that the Appellants are mere unsecured creditors, the Court below found that an equitable lien existed in favor of Appellants and awarded to them 33/70 of the net proceeds to be derived from the sale of ESC #3. Appellee will accept such decision by this Reviewing Court.

Appellee contends that the Appellants have failed to show that the Referee's decision was clearly erroneous and submits that the Order of the United States District Court of February 10, 1967, affirming the decision of the Referee should be affirmed.

Respectfully submitted,

BUCHALTER, NEMER, FIELDS & SAVITCH,

By IRWIN R. BUCHALTER,

Attorneys for Appellee, Curtis B. Danning, Trustee in Bankruptcy.

Certificate.

I certify that, in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those Rules.

IRWIN R. BUCHALTER

APPENDIX A.

Exhibits	Identified	In Evidence
Crane Ex. 1 (Promissory Note)	24	Received p. 25
Crane Ex. 2 (Trust Deed)	26	Received p. 26
Crane Ex. 3 (Bower-White Escrow Instructions)	28	Received p. 28
Crane Ex. 4 (Short Form Escrow Instructions)	28	Received p. 28
Crane Ex. 6 (Application of Trustee to Sell)	31	Rejected p. 32
Crane Ex. 8 (Letter of David Belinkoff dated February 5, 1962)	34	Received p. 35
Canning's Ex. A (Wilshire Escrow Company document entitled "Escrow Settlement" Escrow No. 34757)	43	Received p. 43
Canning's Ex. B (Wilshire Escrow Company document entitled "Escrow Statement" of James A. Bower dated September 10, 1959)	43	Received p. 43
Canning's Ex. C (Wilshire Escrow Company document entitled "Escrow Instructions" dated August 31, 1959)	43	Received p. 43
Canning's Ex. D (Letter dated July 1, 1960 from Ted Harris)	43	Rejected p. 49
Canning's Ex. E (Form of Assignment of Deed of Trust)	88	Received p. 91
Crane Ex. 1 (Alan Realty Co. Accounting)	226-27	Received p. 227
Crane Ex. 2 (August 13, 1959 letter)	246	Received p. 247
Crane Ex. 3 (Bower Sale Documents)	278	Received p. 280
Crane Ex. 4 (Settlement Agreements 10/21/66)	281	Received p. 281
Crane Ex. 5 (Bower Purchase Escrow Documents)	281	Received p. 282
Canning's Ex. A (Claim for Taxes)	287	Received p. 287